How COVID and Brexit put the Kibosh on Business investment

My regular column is available to subscribers on www.thesundaytimes.co.uk This is an excerpt.

So far during this crisis, there has been a lot of emphasis, understandably, on what it means for the economy in general, for unemployment, and for the public finances. We know that the economy suffered a record fall in March and April, and only a modest bounce in May so is 24.5% below pre-crisis levels.

We also know that the unemployment dog has yet to bark in the official figures, where the rate is still, miraculously, below 4%, but that it surely will in coming months. As for the public finances, the question is whether government borrowing this year will be nearer to £300bn or £400bn, both previously unimaginable figures.

There has been little focus so far, however, on something that will drive future prosperity, productive business investment. Without it, there will be no recovery in productivity and no sustained rise in living standards.

Rishi Sunak eschewed measures to boost business investment in his March budget, perhaps because he thought it would be like trying to put up an umbrella in a hurricane, and his summer economic update was all about encouraging consumers to spend and firms to retain workers.

But there is a crisis for business investment, both actual and looming, and it has three causes. The first is the direct effects of the crisis and the economic damage it has caused. A few days ago the Office for Budget Responsibility, in its fiscal sustainability report, set out three scenarios for the economy.

All start from a 40% collapse in business investment in the second quarter, as projects were canceled and firms hunkered down. Only in its upside scenario, which has a rapid recovery in the economy, does business investment quickly get back to where it was pre-crisis, attaining that level in the second quarter of next year.

In both its central and downside scenarios, in contrast, it takes years before business investment gets back to pre-crisis levels and the damage is significant. In the central scenario, business investment is a cumulative 6% lower than previously expected, and its downside scenario, as the OBR puts it, “none of the lost business investment is recovered and cumulative business investment is 10% lower over the whole period”.

The second issue is the distinction between business spending and productive business investment. The Covid-19 crisis has forced firms to spend in ways that they would have had no expectation of doing a few months ago.

Spending on making premises safe, whether offices, factories, shops or other premises is considerable. Businesses are having to invest in safety, just to do what they were doing before, or in many cases a scaled-down version of what they were doing before. Forced spending alongside reduced turnover is a pretty deadly combination.

For many businesses, the calculation is straightforward. This extra spending, which also in most cases increases operating costs, crowds out productive business investment.

The third factor is a familiar one, Brexit. The 2016 referendum snuffed out a promising recovery in business investment and, even before this crisis, left it 20% below what it would otherwise have been, according to the Bank of England.

For business, the Brexit process has gone from bad to worse, from a government ambition to achieve an exit from the EU with minimum disruption to existing trading links and supply chains, to one where such disruption has become central to the Brexit that the current government is aiming for.

Vast new customs processing centres, huge lorry parks in Ashford, and a massive increase in paperwork for exporters and importers are part of the grim and bureaucratic future that form the government’s vision.

Indeed, a good rule of thumb, as some of us warned, is to take the claims of pro-Brexit politicians, and this Brexit government, and turn them on their head. Instead of less red tape, there will be a lot more, for trade and employing foreign workers. Instead of a global Britain, it is closing before our eyes. Where they claim to offer certainty, there is only uncertainty.

Though a no-deal Brexit is the worst outcome, the government's limited ambitions for a post-Brexit trade deal with the EU are not much better. The European Commission has published a list of what will change, even if a trade deal is negotiated this year.

For trade-in goods, there will be customs controls, tariff controls, VAT and excise payments, and checks on conformity with regulatory standards. For trade in services, UK firms will have to demonstrate compliance with service standards, there will be a loss of current rail, air, and road transport licenses and an end to recognition of UK professional qualifications. The settlement for financial services is up in the air.

UK travellers will need a visa to stay in the EU for 90 days or more in any 180 day period, will lose the right to work in the EU and UK driving licences will no longer be recognized. Use of the EU pet passport will end, as will the guarantee of no roaming charges for mobile phones.

If all that happens in the event of what the government would describe as a good deal, you have to wonder. You do not have to wonder that this gives businesses another good reason not to commit to productive investment in Britain.

A no-deal Brexit would be worse. The OBR, in its scenarios, assumed that the UK and EU would "move in orderly fashion" to a "conventional free trade agreement". If not, it said, leaving without a deal "would pose downside risks to short-and medium-term growth prospects on top of the economic challenges created by the pandemic".

No government would want to inflict this on their economy, and on businesses that want to rebuild and invest, would they? It is a depressing fact that this government, which is far from business-friendly and has taken plenty of wrong turns in its short life, may well do so.

Source: http://www.economicsuk.com/blog/002375.html